Amity Shlaes: The key to rebuilding Iraq
By Amity Shlaes
Published: September 28 2003 17:56 | Last Updated: September 28 2003 17:56

So now we learn that Europe does not want to throw more than a few hundred million euros into the pot for a Marshall Plan for Iraq. This is being presented by a huffy American press as a nasty shock. After all, the reconstruction plan is a familiar one: first comes the rescue money, as in Germany of old, then the economic miracle and then democratic stability. Europeans, more than anyone, know the value of such an agenda.

But here is a question: does Iraq really need European money? Aid is important, but Iraq will have its own aid: oil aid. If Iraq is to become another Germany and not a Libya, it needs to write laws and establish institutions that make it an inviting place for capital. That at least is what happened in Germany, where an unknown - the economist Ludwig Erhard - worked with the Allies to create a classically liberal programme after the second world war. Erhard then promoted the plan like crazy over the radio. At times, there were tensions between occupied and occupier; but in the end the result was strong: wage and price controls and high taxes were all swept away. In the long run, Erhard's liberal vision and his laws mattered more than Washington's cash; gross domestic product trebled in a decade.

Seen in this context, the big news about Iraq is not the discussion about aid but Iraq's recent progress in generating free market leadership and free market legislation.

Iraq already has an emerging visionary. He is Ahmad Chalabi, the academic and banker who in recent years has moved from the humiliating edges of exile back to Baghdad and, this month, to the rotating presidency of Iraq's governing council. Mr Chalabi studied at Massachusetts Institute of Technology and the University of Chicago and, like many Chicago products, he is obsessed with the economy.

He notes that a mere 2 per cent of all the globe's foreign direct investment goes to the Middle East. He wants to create an Iraqi economy that will increase the region's share of the pie. The Chalabi dream, which he will be discussing with various members of the US senate this week, is a liberal independent state. The Chalabi nightmare is a sort of bad version of Afghanistan under President Hamid Karzai - an international caretaker semi-state where government is about policing borders and negotiating among ethnic power blocs rather than boosting GDP. For Iraq, he told me over dinner, "we need an Adenauer and an Erhard, not a Karzai".

Another piece of good news is that now Iraq also has a plan: four-part economic legislation passed this month by the governing council and approved by Paul Bremer, the US envoy. The plan is incomplete and flawed. Still, it is refreshingly liberal by Middle Eastern standards. Here are its components.

First the bad news: a "reconstruction surcharge" on goods and capital that cross into Iraq. This is not liberal. And it will deter investment.

Next comes a new banking law, which allows foreign banks to create branches or subsidiaries in Iraq. The law also allows up to six foreign banks to purchase local banks and to purchase them direct - JP Morgan Chase, Citigroup and HSBC have expressed interest.

Tax is next. The governing council has introduced a tax schedule that tops out at 15 per cent for both companies and individuals. Such low rates will put Iraq on a par with Hong Kong and flat-tax-land Russia. They contrast favourably with the onerous regimes of some neighbours. (Saudi Arabia's corporate rate is 30 per cent, despite its oil riches. Why?)

Last comes a new property law that allows foreigners to buy and trade property in Iraq without partners. This is much better than what goes on in much of the rest of the Middle East, or, say, the water torture of mandatory joint ventures that China historically imposed on foreign investors. The same law guarantees the right to repatriate capital. But the property law has an exception: Iraqi oil itself, which is for Iraqis alone. The form of that ownership may be decided later, by an elected government.

This property law embodies Iraq's biggest contradiction. On the one hand, the new property rights are crucial, for when ownership rights are clear, trade flourishes. Even in the past months, as the bullets have flown, several international companies have responded to a tender offer to deliver cell phones to 25m Iraqis. In its way, the plan is a gamble that trade can drag Iraq out of terror.

On the other hand, there is the oil. Here the form of ownership is crucial. Putting the oil into a trust for the people may yield yet another socialised petro-state - the sort that is responsible for the low foreign direct investment in the first place. Selling or distributing oil share vouchers to Iraqi nationals could also be dangerous, if one ethnic group ended up with controlling shares. The best step is to open the oil business to all non-government bidders. This, however, the governing council, including Mr Chalabi, hesitates to do, since it looks like a sell-out to colonialism.

In other words, commodity wealth still curses Iraq, making the challenge of reviving the country harder than that of restoring damaged Germany in its day. But the curse is not insurmountable. The Iraq government can always rewrite the property law. In any case, these early steps acknowledge an Erhardian truth. When it comes to new states, what matter most are leaders and law, not aid.